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NO. 05-1429

IN THE
Supreme Court of the United States

TRAVELERS CASUALTY AND SURETY COMPANY OF AMERICA,
Petitioner

-v.-

PACIFIC GAS AND ELECTRIC COMPANY,
Respondent

On Writ of Certiorari to the
United States Court of Appeals for the Ninth Circuit

BRIEF OF *AMICUS CURIAE* THE SURETY & FIDELITY ASSOCIATION OF AMERICA IN SUPPORT OF PETITIONER TRAVELERS CASUALTY AND SURETY COMPANY OF AMERICA

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STATEMENT OF INTEREST OF AMICUS CURIAE

The Surety & Fidelity Association of America ("SFAA")[1] is a trade association of companies licensed to write fidelity and surety bonds in the United States. The approximately 500 members of SFAA are sureties on the vast majority of such bonds furnished in California and other states.

Surety bonds are provided in return for both a premium and an agreement by the bond principal to indemnify the surety against liability, loss and expense, including attorneys' fees, incurred by reason of the execution of the bonds. In the instant case, the contracts between petitioner Travelers Casualty and Surety Company of America, as administrator for Reliance Insurance Company ("Travelers")[2] and respondent Pacific Gas and Electric Company ("PG&E") obligated PG&E to indemnify Travelers for Traveler's attorneys' fees. The Ninth Circuit Court of Appeals refused to enforce the attorneys' fee

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[1] No person or entity other than The Surety & Fidelity Association of America made any monetary contribution to the preparation or submission of this Brief, and counsel for the parties did not author this Brief in whole or in part.

[2] The indemnity agreements named, and the bonds were furnished by, Travelers' predecessor in interest, Reliance Insurance Company.

provisions of the indemnity contracts because the dispute between Travelers and PG&E was decided under federal bankruptcy law instead of state law.

If this Court were to adopt the Rule created by the Ninth Circuit, sureties would be deprived of a part of the consideration promised to induce them to furnish bonds. Indemnity agreements similar to the ones provided by PG&E are routinely required in connection with all types of surety bonds. SFAA's members have an interest in the resolution of the issue presented in this case.

Both Petitioner and Respondent have consented to the filing of this Brief.

SUMMARY OF ARGUMENT

The Ninth Circuit Court of Appeals rejected Travelers' argument that state law should control its claim to recover attorneys' fees incurred in protecting its rights in PG&E's bankruptcy proceeding. Even if federal law applied, however, the Ninth Circuit failed to follow this Court's precedents. The American Rule on attorneys' fees applicable in cases arising under federal law is that fees may be recovered if provided for in an enforceable

contract. Thus, the Ninth Circuit's holding was contrary to both state and federal law.

The Ninth Circuit's Rule dates from *Fobian v. Western Farm Credit Bank (In re Fobian)*, 951 F.2d 1149, 1153 (9th Cir. 1991), but the authorities cited in *Fobian* do not support its result. There is nothing in the *Fobian* opinion to justify or explain disregarding the American Rule's exception for fees authorized by contract just because the dispute arose under the Bankruptcy Code.

This case presents an important, recurring question that impacts a wide range of contracts in addition to indemnity agreements required in connection with all types of surety bonds. If otherwise valid attorneys fee shifting clauses are arbitrarily disregarded, the attorneys fees that are not collected from defaulting parties will be included in the cost of the prevailing party's products or services and paid for by its customers. It is logical and economic to place the cost of litigation on the losing party that bargained to pay it rather than on non-defaulting customers of the prevailing party.

ARGUMENT

The Bankruptcy Code neither provides generally for recovery of attorneys fees nor prevents the parties to a dispute from shifting attorneys fees by contract. The Ninth Circuit Court of Appeals developed its own Rule that enforced, or refused to enforce, contractual attorneys fee shifting based on the law used to resolve the underlying dispute. If state law controlled the dispute, the Ninth Circuit applied state law to decide the attorneys fee issue. If bankruptcy law controlled the dispute, however, the Ninth Circuit refused to permit shifting of attorneys fees in the absence of bad faith or harassment.

Travelers argues that its attorneys fee claim should have been allowed as a matter of bankruptcy law and that the Bankruptcy Court should have applied California law to the fee claim. SFAA will not repeat those arguments and files this Brief to address an alternative basis to allow the fee claim by applying the American Rule under federal law.

I. The Ninth Circuit Rule

The Ninth Circuit Court of Appeals decision in this case[3] was that "attorneys fees are not recoverable in bankruptcy for litigating issues 'peculiar to federal bankruptcy law.'"[4] The Ninth Circuit's decision did not depend on the attorneys' fee provision of the parties' contract or on which party prevailed. The Court followed a bright line rule that parties cannot contract to shift attorneys' fees incurred litigating issues controlled by bankruptcy law.

In a companion case, *DeRoche v. Arizona Industrial Commission*,[5] the Ninth Circuit stated its Rule as follows:

> However, we consistently have refused to award fees when the substantive

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[3] *Travelers Casualty and Surety Company v. Pacific Gas and Electric Company*, 2006 WL 285977 (9th Cir. February 7, 2006), Petition Appendix page 1a.

[4] Pet. App. p.3a, quoting from *Fobian v. Western Farm Credit Bank*, 951 F.2d 1149, 1153 (9th Cir. 1991).

[5] 434 F.3d 1188 (9th Cir. 2006), a Petition for Writ of Certiorari is pending in the *DeRoche* case, Case No. 05-1439.

> legal question was governed by federal bankruptcy law, rather than "basic contract enforcement questions," even when the underlying contract contains an attorney fee provision enforceable under state law.

(434 F.3d 1191).

The Ninth Circuit decisions in the instant case and *DeRoche* both relied on *Fobian v. Western Farm Credit Bank (In re Fobian)*, 951 F.2d 1149, 1153 (9th Cir. 1991), *Cert. Den.* 505 U.S. 1220 and 1221 (1992). In *Fobian* the Court explained:

> Where a contract or statute provides for an award of attorneys' fees, a creditor may be entitled to such fees in bankruptcy proceedings. Such an award is governed by state law. . . . However, where the litigated issues involve not basic contract enforcement questions, but issues peculiar to federal bankruptcy law, attorney's fees will not be awarded absent bad faith or harassment by the losing party.

(951 F.2d 1153).

Thus, the predicate for the Ninth Circuit's decision in the instant case was that contractual attorneys fee provisions are unenforceable under federal law. If state law had controlled the decision, the Ninth Circuit would have followed California law and enforced the contract. Because Federal bankruptcy law controlled, the Ninth Circuit held that the attorneys fee provisions of the indemnity contracts were not enforceable.

SFAA respectfully suggests that the Ninth Circuit holding conflicts with this Court's application of the American Rule in matters controlled by federal law.

II. The American Rule Under Federal Law Enforces Contractual Attorneys' Fee Provisions

In matters controlled by federal law, the American Rule is to enforce contractual attorneys' fee provisions. *Fleischmann Distilling Corp. v. Maier Brewing Co.*, 386 U.S. 714, 87 S. Ct. 1404, 18 L. Ed.2d. 475 (1967), arose

under the Lanham Act.[6] The Court stated the American Rule as:

> The rule here has long been that attorney's fees are not ordinarily recoverable in the absence of a statute or enforceable contract providing therefor.

(386 U.S. 717, 87 S. Ct. 1407).

F.D. Rich Co., Inc. v. U.S. ex rel. Industrial Lumber Co., Inc., 417 U.S. 116, 94 S. Ct. 2157, 40 L. Ed. 2d 703 (1974), held that an action on the payment bond required by the Miller Act[7] was governed by federal law and the Ninth Circuit erred in resorting to "state policy" to award fees. This Court stated:

> The Miller Act provides a federal cause of action, and the scope of the remedy as well as the substance of the rights created thereby is a matter of federal not state law. Neither respondent nor the court below offers any evidence of congressional intent to

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[6] 15 U.S.C. §§1051, et seq.

[7] 40 U.S.C. §§ 3131, et seq.

> incorporate state law to govern such an important element of Miller Act litigation as liability for attorneys fees.

(417 U.S. 127, 94 S. Ct. 2164).

The Court in *F.D. Rich* also recognized that a contractual attorneys' fee provision would be enforced. The Court, citing *Fleischmann Distilling Corp.*, stated:

> We turn now to the question of whether attorneys' fees were properly awarded respondent as a successful Miller Act plaintiff. The so-called 'American Rule' governing the award of attorneys' fees in litigation in the federal courts is that attorneys' fees 'are not ordinarily recoverable in the absence of a statute or enforceable contract providing therefor.' . . . There was no contractual provision concerning attorneys' fees in this case.

(417 U.S. 126, 94 S. Ct. 2163).

See also, *Summit Valley Industries, Inc. v. Local 112, United Brotherhood of Carpenters and Joiners of America*, 456 U.S. 717, 721, 102 S. Ct. 2112, 2114, 72 L.

Ed.2d 511 (1982)("Under the American Rule it is well established that attorney's fees 'are not ordinarily recoverable in the absence of a statute or enforceable contract providing therefor.'"); *Hall v. Cole*, 412 U.S. 1, 4, 93 S.Ct. 1943, 1945, 36 L. Ed.2d 702 (1973)("Although the traditional American Rule ordinarily disfavors the allowance of attorneys' fees in the absence of statutory or contractual authorization. . ."); *Alyeska Pipeline Service Company v. Wilderness Society*, 421 U.S. 240, 257, 95 S. Ct. 1612, 1621, 44 L. Ed.2d 141 (1975)("Other recent cases have also reaffirmed the general rule that, absent statute or enforceable contract, litigants pay their own attorneys' fees.")

Following *F.D. Rich*, courts, including the Ninth Circuit,[8] have awarded attorneys' fees to successful Miller Act payment bond claimants if their contracts provided for fees. This is not because state law entitled them to fees. It is because the American Rule under federal law enforces fee shifting by contract.

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[8] *United States ex rel. Reed v. Callahan*, 884 F.2d 1180, 1185-1186 (9th Cir. 1989), *Cert. Den. Esto, Inc. v. Callahan*, 493 U.S. 1094 (1990); *United States ex rel. Palmer Construction, Inc. v. Cal. State Elec., Inc.*, 940 F.2d 1260 (1991); *North Star Terminal & Stevedore Co. v. Nugget Construction, Inc.*, 126 Fed. Apx. 348, 2005 WL 487313 (9th Cir. 2005).

Thus, in the instant case, the Ninth Circuit reached a result contrary to both state and federal law. Nothing in the Bankruptcy Code forbids parties from allocating the cost of attorneys' fees by contract. California law and federal law recognize such contracts as an exception to the American Rule. If Congress wanted to forbid enforcement of contractual fee shifting in cases decided under the Bankruptcy Code, it could have done so. In the absence of such a statute, however, the Ninth Circuit was not free to legislate its own Ninth Circuit law contrary to both state law and this Court's decisions on federal law.

III. *Fobian* is not Persuasive Authority for the Ninth Circuit's Rule

The Ninth Circuit Rule at issue in this case rests upon *Fobian v. Western Farm Credit Bank*, supra., but *Fobian* did not explain its failure to apply the American Rule as a matter of federal law to enforce the contractual attorneys fee provision. In *Fobian* the bank successfully opposed confirmation of the Fobians' Chapter 12 plan and sought attorneys fees pursuant to provisions in the promissory note and deed of trust that provided "for the payment of fees and costs incurred in collection of amounts due or enforcement of rights." (951 F.2d 1153). The Court rejected the fee claim.

In each of the four cases that *Fobian* cited in connection with the attorneys fee issue, the attorneys fee claim depended on state law. In *Johnson v. Righetti (In re Johnson)*, 756 F.2d 738 (9th Cir. 1985) the contract provided that the sellers could recover attorneys fees. The buyers defaulted on the loan payments and filed for bankruptcy. The buyers then prevailed in the sellers' action to lift the automatic stay. The buyers had no contractual claim to attorneys fees, but relied on Cal. Civ. Code §1717, which provided that "In any action on a contract" any attorneys fee provision would be mutual for the benefit of the prevailing party. The Court held that the litigation for relief from the automatic stay was not an "action on a contract" and denied recovery of fees pursuant to §1717 because §1717 by its terms did not apply.

In *Grove v. Fulwiler (In re Fulwiler)*, 624 F.2d 908 (9th Cir. 1980), a promissory note obligated the debtor, Mr. Fulwiler, to pay attorneys fees incurred in collection of the note. Mr. Fulwiler successfully opposed the creditor's petition to set aside Mr. Fulwiler's bankruptcy discharge, and Mr. Fulwiler sought attorneys fees. The Court noted that, "Fulwiler based his request for attorney's fees upon a state statute, ORS (Oregon Revised Statutes) 20.096 which makes an attorney's fees clause reciprocally binding

regardless of the actual wording of the clause." (624 F.2d 909). Since the non-dischargeability proceeding was purely a question of federal law, the debtor's claim to fees was denied.

Merced Production Credit Association v. Sparkman (In re Sparkman), 703 F.2d 1097 (9th Cir. 1983) awarded fees to the debtor who prevailed on a state law counterclaim against a lender. The Court stated, "Thus, Sparkman's entitlement to attorneys' fees in the present case turns upon state law, not the American Rule."

Finally, *Collingwood Grain, Inc. v. Coast Trading Company, Inc. (In re Coast Trading Company, Inc.)* , 744 F.2d 686 (9th Cir. 1984) denied both sides' attorneys fee claims. The dispute involved an unpaid seller's rights under the Uniform Commercial Code, and the Court noted that both claims depended on Oregon statutes. The Court also held, "attorneys fees are not available for the litigation of federal bankruptcy issues under a contract which provides for attorneys' fees for enforcement of the contract."

Thus, in each of the cases cited in *Fobian*, there was no otherwise applicable contract for fees. Either the

contract did not cover the fees incurred or the fee claim depended on a state statute rather than the contract. Nevertheless, the Court adopted a broadly worded Rule that attorneys fees would not be awarded if the issues litigated were peculiar to federal bankruptcy law.

There is some logic to holding that attorneys fees that can be claimed only under a state statute are not recoverable in a case controlled entirely by federal bankruptcy law or that a contract that provides for fees incurred to enforce the contract does not entitle a party to fees incurred in connection with some other type of claim. In the instant case, however, Travelers' right to fees does not depend on any state statute, and the indemnity contracts obligate PG&E to pay Travelers' fees incurred "by reason of the execution of the bonds," not just fees to enforce PG&E's indemnity contracts.

Travelers incurred fees to protect its rights in PG&E's bankruptcy proceeding. The lower courts denied recovery of those fees without regard to the terms of the indemnity contracts or the identity of the prevailing party. The Ninth Circuit squarely held that the fees could not be recovered because federal bankruptcy law controlled the litigation.

The American Rule applicable to matters controlled by federal law, however, permits shifting of attorneys fees by contract. The Ninth Circuit's decision in *Fobian*, followed in the instant case, conflicts with this Court's application of the American Rule under federal law and should be reversed.

IV. Logic and Public Policy Favor Reversal of the Courts Below

PG&E could have met its obligations to injured employees by purchasing workers compensation insurance. Instead of paying to have an insurer assume the obligations, however, PG&E chose to self-insure and pay the workers itself. Under California law, it had to provide security for its obligations to the injured workers.[9] A surety bond was one of the permitted forms of security.[10]

Unlike an insurer, the surety on the bond did not take over primary responsibility for the benefits. PG&E remained primarily liable, and the surety merely guaranteed PG&E's performance. The risk the surety ran was that workers would be owed benefits and that PG&E would be unable to pay them.

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[9] Cal. Labor Code §3701.

[10] Cal. Labor Code §3701(d).

To induce Travelers to become surety on the bonds, and thus assume a potential $100 million liability, and to keep the cost of the bonds as low as possible, PG&E executed the indemnity agreements. In Paragraph Second of the first two Agreements, PG&E promised:

> SECOND: To indemnify, and keep indemnified, and hold and save harmless the Surety against all demands, claims, loss, costs, damages, expenses and attorneys' fees whatever, and any and all liability therefor, sustained or incurred by the Surety by reason of executing or procuring the execution of any said Bond or Bonds, or any other Bonds, which may be already or hereafter executed for or at the request of the Undersigned, or renewal or continuation thereof; or sustained or incurred by reason of making any investigation on account thereof, prosecuting or defending any action brought in connection therewith, obtaining a release therefrom, recovering or attempting to recover any salvage in connection therewith or enforcing by litigation or otherwise any of the agreements herein

> contained. Payment of amounts due Surety hereunder together with legal interest shall be payable upon demand.

(Excerpts of Record in the Ninth Circuit at pp. 41 and 45).

The third agreement stated at its second paragraph, "PG&E Corporation agrees to indemnify the Surety and hold [it] harmless in respect of any and all loss, damages, claims, costs, premiums, expenses and reasonable attorney's fees which the Surety may incur by reason of its having furnished the aforesaid Workers Compensation Bond." (Excerpts of Record at p. 51).

PG&E did not just agree to indemnify Travelers for losses paid under the bonds.[11] It also promised to indemnify Travelers for expenses, including attorneys' fees, incurred "by reason of executing" the bonds. Paragraph Second then goes on to obligate PG&E to pay any attorneys' fees incurred in connection with enforcement of the indemnity agreement. Thus, PG&E's promise to pay Travelers' attorneys' fees was not limited to actions on the indemnity contract itself. Any fees incurred by reason of the execution of the bonds were covered.

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[11] Indeed, such a promise would be largely superfluous because Cal. Civ. Code §2847 would obligate PG&E as principal on the bonds to pay Travelers for any losses.

Surety bonds are required in connection with a multitude of activities including all public construction projects over a minimal size.[12] Indemnity agreements substantially similar to the ones PG&E provided Travelers are routinely obtained in connection with all kinds of surety bonds.[13] These agreements help reduce the cost of bonds and assure that any losses and expenses are paid by the bond principal or other persons or entities who agree to act as indemnitors for the principal's obligations to the surety. If bond principals do not have to live up to their promises because a dispute is decided under federal bankruptcy law instead of state law, the loss experience and costs of bonds will increase.

The same is true for other types of transactions in which attorneys' fee shifting provisions are used. If one party is obligated to pay the other party's attorneys' fees, the indemnified party can charge less for its products or

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[12] For federal construction, the Miller Act, 40 U.S.C. §§ 3131, et seq., requires performance and payment bonds. In California, Civ. Code §3247 requires payment bonds on public construction contracts.

[13] See, Klinger, et al., *The Surety's Indemnity Agreement* (American Bar Association 2002) and Shahinian, "The General Indemnity Agreement" in Gallagher, ed. *The Law of Suretyship, 2nd Ed.* (American Bar Association 2000) at pp. 487-525.

services. It recovers the cost of enforcing the contract from the defaulting party. If such an indemnification provision is unenforceable, the attorneys' fees have to be factored into the cost of the products or services. Then, all parties purchasing the products or services pay an increased price. The attorneys' fees are spread over all customers rather than being paid by the defaulting party.

In the instant case, PG&E is well able to pay Travelers' attorneys' fees, but the Ninth Circuit rule bars enforcement of the attorneys' fee provisions in the indemnity agreements. In this one instance, the consequences to Travelers' other customers may be minimal, but applied to the myriad of contracts with attorneys' fee shifting provisions, the cumulative effect of the Ninth Circuit rule is substantial.

CONCLUSION

This Court should reverse the Ninth Circuit Court of Appeals and hold that the American Rule, as articulated by this Court in matters of federal law, requires enforcement of otherwise valid contractual fee shifting provisions in cases governed by federal bankruptcy law.

Respectfully submitted,

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